Office-Supreme Court, U.S.
FILED
JUN 1 1966
JOHN F. DAVIS, CLERK

LIBRARY
SUPREME

No. 1501 727
No. 1502 728

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

FEDERAL POWER COMMISSION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

MEMPHIS LIGHT, GAS AND WATER DIVISION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

BRIEF OF RESPONDENT, UNITED GAS PIPE LINE COMPANY, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

Of Counsel:

W. O. CRAIN
General Counsel
P. O. Box 1407
Shreveport, La. 71102

K. W. KOLBE
C. D. FRENCH
2 Rector Street
New York, N.Y. 10006

LYNN R. COLEMAN
2024 First City National Bank Building
Houston, Texas 77002

THOMAS FLETCHER
2025 First City National Bank Building
Houston, Texas 77002

Attorney for Respondent United Gas Pipe Line Company

FIDELITY PRINTING COMPANY, INC., HOUSTON

INDEX

	Page
COUNTER-QUESTION PRESENTED	1
COUNTER-STATEMENT OF THE FACTS	2
(a) Proceedings before FPC	2
(b) The Judgment of the Court of Appeals	3
ARGUMENT	4
The Fifth and Tenth Circuits Correctly Construe and Enforce, Within the Ambit of the Act, Applicable Tax Principles	4
Only Statutory Tax Rate Applies in Consolidated Tax Return Situation	4
Tax Liability of United Group Increased by 52% of United's Taxable Income	6
"Consolidated Effective Tax Rate" an FPC device to Escape and Lower Tax Provided by Statute	8
Memphis' Claims Unfaithful to Fifth Circuit Decision	8
Conflict between Memphis and FPC	10
Wellhead to Burner-Tip "System" — Misleading	11
Speculative Claims of Advantages from Affiliation — Without Substance	11
Controlling Regulation, Qua Statutes, Require Preservation of Separate Entity	13
FPC Reliance on *El Paso* Misplaced	15
No Important Federal Question Calling for Supervision of this Court	16
Issues judicially reviewed	16
No Basis for Claim of Hurtful Public Impact	17
CONCLUSION	22

AUTHORITIES

American-Louisiana Pipe Line Co. v. FPC, 344 F 2d 525	21
Cities Service Gas Co., 30 FPC 158	2, 3, 10, 16
Cities Service Gas Co. v. FPC, 337 F 2d 97	3, 4, 5, 6, 7, 8, 10, 13, 17, 19, 21, 22, 23
Colorado Interstate Gas Co. v. FPC, 324 US 581	9, 16
Erie Lighting Co. v. Commission of Internal Revenue, 93 F 2d 883	13, 14
El Paso Natural Gas Co. v. FPC, 281 F 2d 561, cert. den. sub nom. California v. FPC, 336 US 912	15

	Page
FPC v. Hope Natural Gas Co., 320 US 59	19
Investigation of Rates and Charges to West Indies, 10 FCC 32	19
Mississippi River Fuel Co. v. FPC, 252 F 2d 619	20
Panhandle Eastern Pipe Line Co. v. FPC, 324 US 635	16
United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division, 358 US 103	20
Western Union Telegraph Co., 25 FCC 532	19
Willmut Gas and Oil Co. v. FPC, 299 F. 2d 111	20

Statutes and Regulations

Natural Gas Act; June 21, 1938, c. 556, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717w, Sec. 4(d)	2
Revenue Act of 1928	14
Revenue Act of 1934	14
Treasury Regulations § 1.1502-15	9
Treasury Regulations § 1.1502-30(a)	5
Treasury Regulations § 1.1502-31(b)	5

Others

Annual Report of United Gas Corporation (1964)	11
Consolidated Tax Return (Callaghan & Co. 1959) Fred W. Peel, Jr.	14
FPC Form 2 for United Gas Pipe Line Company (1964)	11
H. Rep. No. 704, 73d Cong. 2d Sess.	14
S. Rep. No. 960, 70th Cong. 1st Sess.	14

No. 1301
No: 1302

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

FEDERAL POWER COMMISSION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

MEMPHIS LIGHT, GAS AND WATER DIVISION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

BRIEF OF RESPONDENT, UNITED GAS PIPE LINE COMPANY, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

COUNTER-QUESTION PRESENTED

Where a group of affiliated companies, which includes United,[1] files a consolidated Federal income tax return,

[1] In this brief references will sometimes be made as follows: United Gas Pipe Line Company, "United"; the Federal Power Commission, "FPC"; Staff of FPC, "Staff"; Memphis Light, Gas and Water Division, "Memphis"; Union Producing Company, an affiliate of United, "Union"; United Overseas Production Corporation, an affiliate of United, "Overseas"; United Gas Corporation, the parent of United, Union and Overseas, "Corporation"; and the Natural Gas Act will sometimes be referred to as the "Act". All emphasis will be that of the writer unless otherwise noted.

and where said return reflects tax losses of one or more of United's affiliates, which losses arise from, or include deductions from, non-utility operations which are not subject to the jurisdiction of the FPC and which are wholly unrelated and disassociated from the operations of United:

Should said losses or deductions from such unrelated, non-jurisdictional and non-utility operations be utilized by the FPC in computing the Federal income tax component to be included in United's cost of service on which United's regulated rates for the sale of gas are based?

COUNTER-STATEMENT OF THE FACTS

(a) **Proceedings Before FPC.** United, a natural gas company subject to FPC regulation, filed under § 4(d) of the Act, application for general increase of its jurisdictional rates. After full hearing, the FPC, on May 14, 1964, issued a rate order and Opinion No. 428 (R. 9107). Thereafter on rehearing, it issued two Opinions, No. 428-A on September 2, 1964 (R. 9704), and No. 428-B, on September 30, 1964 (R. 9859).

After petitions to review were filed in the Fifth Circuit, all issues before the FPC were settled except the Federal income tax allowance includible in United's cost of service — the only issue presented below for decision.

The FPC, in computing such Federal income tax allowance, applied a so-called "consolidated effective tax rate", lower than the applicable statutory corporate tax rate, which the FPC claims resulted from United joining its affiliates in filing a consolidated Federal income tax return. The FPC, declaring complete applicability and governance of its Opinion in *Cities Service Gas Co.*, 30 FPC 158, applied, to United, the *Cities Service* formula devised to synthesize the so-called "consolidated effective tax rate", and substituted it for the statutory rate.

United contends that it is entitled, the FPC obligated, to apply to its taxable income only the statutory rate in computing the allowance for Federal income taxes includible in its cost of service, unreduced by tax losses and deductions attributable to unrelated, non-jurisdictional, and non-utility operations of affiliated companies.

The FPC action gives United's jurisdictional gas customers the benefits of tax losses and deductions which are not United's but which arise mainly from unrelated, non-jurisdictional and non-utility *oil* operations of United's affiliate, Union, whose costs are not included in United's cost of service.[2]

(b) **The Judgment of the Court of Appeals.** In the Fifth Circuit, United asserted direct, unequivocal support for its contentions in the Tenth Circuit decision in *Cities Service Gas Co.* v. *FPC*, (1964) 337 F. 2d 97 (App. A, FPC Pet.), involving precisely the same issue before the Fifth Circuit.

The Tenth Circuit reversed and set aside the "method" devised by the FPC in *Cities Service*, which it applied to United. The Tenth Circuit held that "No 'tax savings' resulted from the inclusion of the Gas Company in the consolidated return" (App. 28); that "We think it is legally fallacious to calculate the Gas Company's tax allowance on the basis of the consolidated tax liability of the parent Company" (App. 27); and after demonstrating that "the reduction in the total tax liability effected by the consolidated returns is due to the losses of the nonregulated companies", it concluded, "It is thus plain that the apportionment of the total tax liability among the regulated companies fails to comply with the jurisdictional requirement for the separation of regulated and nonregulated

[2] The consolidated group included in 1961, Overseas, which is completely unregulated, and which had oil exploration operations in Africa (R. 516) producing a loss of $24,354.

profits and losses which Congress wrote into the Act, and which the Commission prescribed for itself. The Commission's method is therefore unauthorized and its order based thereon must be set aside." (App. 29, 30).

The Fifth Circuit studied this record and the Tenth Circuit decision, and concluded:

> "United would have us follow the Tenth Circuit's *Cities Service* decision. The Commission says that the *Cities Service* case is to be distinguished because of fact differences. It urges that the Tenth Circuit decision is wrong and should not be followed. We do not think there are any such fact differences between Cities Service and this case as call for the application of any different rule of decision. The Court in the Tenth Circuit case held that the tax allocation as made by the Commission's order was contrary to the requirements which Congress had imposed. We think the Tenth Circuit case is correct and that the principles which are announced in its Opinion are here applicable and controlling. The Commission's order, using an incorrect income tax rate in computing cost of service for the fixing of United's gas rates is erroneous and must be Vacated and set aside." (App. 20).

Thus, two Courts of Appeal were unanimous in holding the FPC orders unlawful in the jurisdictional aspects noted. This upheld the two Commissioners who dissented in the *Cities Service* and *United* proceedings. We find no court decision to the contrary.

ARGUMENT

THE FIFTH AND TENTH CIRCUITS' DECISIONS CORRECTLY CONSTRUE AND ENFORCE, WITHIN THE AMBIT OF THE ACT, APPLICABLE TAX PRINCIPLES

Only statutory tax rate applies in consolidated tax return situation. The decisions of the Fifth and Tenth Circuits

correctly reflect fundamental tax principles. They recognize that the pertinent tax statute prescribes only one tax rate — 52%. FPC and Memphis unsuccessfully sought to saddle United with a hypothetical, fictional "consolidated effective tax rate" — a complete stranger to the tax statute.

Both Circuits so recognized in requiring application of the statutory rate — the rate applied to United's taxable income — in determining the issue the FPC and Memphis pose here.

The Fifth Circuit, agreeing with the Tenth Circuit, correctly recognizes that if United filed a separate return, its tax allowance in cost of service would be computed at the statutory rate of 52%.

Implicit in the Fifth Circuit's decision is recognition that United, by joining in the filing of a consolidated return, retains its status as a separate entity as directed by governing tax Regulations.

Upon filing a consolidated return, a tax is paid on the group's aggregate taxable income. There is no merging or commingling of income and deductions of members in the affiliated group in the sense that separate corporate identity is lost. To the contrary, the tax Regulations — having the force of statute — preserve the separate corporate identity by specifically providing (Reg. Sec. 1.1502-30(a)) that tax liability shall be computed upon consolidated income, defined in the Regulations (Reg. Sec. 1.1502-31(b)), as a *combination* of taxable incomes, *computed separately*, of the members of the affiliated group. As these Regulations prescribe, so did the United group.

So, each company retains separate corporate identity; each company remains a separate corporate entity. Equal-

ly, both Circuits preserved the intent of the Regulations; both directed compliance with the statutory rate to compute tax allowance.

For the FPC to prevail, it would be necessary to calculate United's tax allowance, not on the basis of its own tax liability based on its own taxable income, but on the basis of the consolidated tax liability of the parent corporation. This is exactly what the FPC unsuccessfully attempted below and in the Tenth Circuit. The Tenth Circuit rejected, stating ". . . it is legally fallacious to calculate (Cities Service) Gas Company's tax allowance on the basis of the consolidated tax liability of the parent company." (App. 27).

Tax Liability of United Group Increased by 52% of United's Taxable Income. The Fifth and Tenth Circuit decisions correctly held that United and Cities Service incurred tax liability at the statutory 52% rate, and that the consolidated returns actually so reflected. It is perfectly clear that the tax liability of United's consolidated group was increased by exactly 52% of United's taxable income included in the consolidated return. The same situation existed in *Cities Service*.

The Tenth Circuit demonstrated that inclusion of Cities Service in the consolidated return increased consolidated tax liability by 52% of Cities Service income, so no "tax savings" followed from inclusion of Cities Service in the return. The Tenth Circuit employed a table (App. 28, fn. 4) clearly showing that inclusion of Cities Service in the consolidated returns increased consolidated tax lia-

bility by 52% of Cities Service's income. United employed the same type of table in the Fifth Circuit as follows:

Year	(1) Consolidated Tax — Including United[3]	(2) Consolidated Tax — Excluding United[4]	(3) United's Separate Tax at 52%[5]	(4) Sum of (2) Plus (3)
1957	$13,560,947	$ 240,742	$13,320,205	$13,560,947
1958	16,091,376	4,352,910	11,738,466	16,091,376
1959	11,356,973	470,069	10,886,904	11,356,973
1960	8,250,373	(885,735)	9,136,108	8,250,373
1961	7,940,211	(1,721,131)	9,661,342	7,940,211
Total	$57,199,880	$ 2,456,855	$54,743,025	$57,199,880

Such table conclusively demonstrates that inclusion of United in each return, for the five year representative period, increased consolidated tax liability of the affiliated group by 52% of United's income included in the consolidated return. It follows that no "tax savings" resulted from inclusion of United in the return. This was the precise result adjudged in *Cities Service*.

Below Memphis characterized United's table as a "shell game", saying such could as effectively be used for Corporation. But, United's table, like that of the Tenth Circuit, irrefutably shows that inclusion of United in the consolidated return had no effect on United save that which followed application of the statutory rate to United's taxable income. It necessarily follows, as both Circuits knew and declared, that the FPC's "device" to reduce the statutory tax rate and substitute therefor a

[3] After adjustment for capital gains. R. 9149.

[4] This amount is determined by subtracting United's taxable net income as it appears at R. 6524 (as adjusted for capital gains), from the consolidated taxable net income appearing at R. 6524 (as adjusted for capital gains), and multiplying the difference by 52%.

[5] This amount is determined by multiplying United's taxable net income (R. 6524), as adjusted for capital gains (R. 6215, 6219) by 52%.

"consolidated effective tax rate" hinged solely on Union's *unregulated oil losses* — tax losses beyond the jurisdictional reach of the FPC.

"Consolidated Effective Tax Rate" An FPC Device to Escape and Lower Tax Provided by Statute. The Fifth Circuit, declaring the Tenth Circuit's decision controlling, repudiates any theory that United's position is based on a theoretical or hypothetical tax.

This record indisputably shows that a tax resulting from application of the statutory rate to United's taxable income for the five year period utilized, was, in fact, paid. United's complaint was that the FPC instead of recognizing that clear fact, contrived a "consolidated effective tax rate" to derogate and reduce the tax allowance which United was lawfully entitled to have included in its cost of service — contrary to the rate Congressionally commanded. The Fifth Circuit rightfully redressed United's complaint.

Thus, the Fifth and Tenth Circuits fully recognize the fundamental axiom that income tax results from application of a *statutory* tax rate to taxable income. Hence, there is no such thing as a "consolidated effective tax rate." It is thus unmasked as a device, unlawfully to assign tax losses and deductions to companies having no right thereto. There is only one tax rate available for use to the FPC — and that rate is prescribed only by statute — the Internal Revenue Code.

Memphis' Claims Unfaithful to Fifth Circuit Decision. Memphis' claim, (p. 4), that the decision below "will require * * * consumers to pay, in rates an amount for Federal income tax in excess of the public utility's Federal income tax liability * * *" is nonsensical. Federal income tax results from application of the statutory rate to tax-

able income. United's "tax liability" cannot exceed income taxes so computed. Of course, by express provision of Regulation § 1.1502-15, United, joining in a consolidated return, is liable *in solido* for the consolidated tax.

Further, the Memphis notion (p. 4) that "*applicable cost* allocation procedures" must be ignored,[6] and that one joining "in a consolidated tax return *experiences* a similar tax liability * * *" begs the question. There are no "applicable allocation procedures", for taxes are not a joint cost requiring apportionment. Assuming them so does not make them so. United's tax liability issues only from its own separate taxable income. It "experiences" nothing but that liability.

The further assumption that these "experiences" result from "recurring tax losses of an affiliated *gas* producer" (p. 4) is even more unwarranted. This record shows that Union had an aggregate taxable income for the pertinent five year period *from gas* of $507,254 (Ex. 14-1, Sch. 2, R. 6210). The losses here arise from Union's non-jurisdictional, non-utility, unrelated *oil* operations.

Memphis (p. 6) misconceives *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581. This Court there dealt with method of rate making, not method of allocation. The "pragmatic adjustments" pointed to rate methods. Allocation plays a rate-making part in separating jurisdictional from non-jurisdictional, as that case makes clear, so that rate methods within the frame work of the Act can be properly applied — or as in the Memphis illustration (p. 6), where oil and gas are produced from one well and the joint cost of production is allocated between jurisdictional and non-jurisdictional for the same purposes. It was the FPC refusal to allow separate incurrence of tax liability to remain separate, and

---

[6] What is said here also applies to the FPC which advances the same claims (pp. 9, 10, 13).

its affirmative attempt to break out of the jurisdictional enclosure so as to mix non-jurisdictional with jurisdictional, to its own ends, that constituted the vice of illegality struck down by the Fifth and Tenth Circuits.

Conflict Between Memphis and FPC. To this point, (p. 7-8), Memphis has faithfully echoed each FPC claim, but here disarray appears. Memphis declares that the so-called three step "allocation" of the FPC *Cities Service* opinion "assiduously respected the limits of its jurisdiction." The FPC, however, is forced to confess (fn. 8, p. 10) that such "formula" does allocate, "the entire tax saving resulting from losses on unregulated activities to the regulated members" (*i.e.*, United).

The FPC suggests that this "problem", "need not be faced here" — but that "problem" it is, which produced the appeals by Cities Service in the Tenth Circuit and United in the Fifth Circuit, and the decisions of which FPC complains. The "problem" has been faced, and resolved, by the Fifth and Tenth Circuits. So, these petitions should be denied.

The responsibility of the FPC goes deeper than its Footnote 8 discloses, for United says that the application to it of the so-called "consolidated effective tax rate" was the result of design not connected with considerations of "tax savings" or "allocation" problems — and this is so, whether there are three steps or no steps. At the hearing level, United pressed the Staff witness on the baneful effect of the "consolidated effective tax rate" device, at which Staff Counsel Berkeley boldly interrupted to declare:

> "MR. BERKELEY: We will be glad to stipulate with you that the use of the consolidated tax *technique* will give to the benefit of United Gas Pipe Line customers, if you look at consolidated taxable income and actual consolidated tax, an effective tax rate lower than

52 percent, and that this results from taking into account Union's losses on oil as well as Union's losses on gas.

"MR. FLETCHER: Do I understand that the stipulation also includes that it was the *intended purpose* of the staff to take those benefits and give them to the customers of United Gas Pipe Line Company?

"MR. BERKELEY: *It was that purpose* to the extent that it reflects the actual effective tax rate paid by the three companies that participate in the tax return, yes." (R. 3468).

Wellhead to Burner-tip "System" — Misleading. The FPC statement (p. 5) that Union, United and Corporation "constitute an integrated gas utility system from wellhead to consumers premises" is not so. Below, we exposed this same statement as grossly misleading, for the truth is that less than one percent of Union's gas found its way to the burner tips of Corporation's customers.[7] Its repetition here is shocking.

Speculative Claims of Advantages from Affiliation — Without Substance. The FPC (p. 11) in effect says that Union and the consolidated group need and depend on United's profits to achieve a "tax savings" for the consoli-

---

[7] Using the same 1964 Annual Report of Corporation which the FPC used (fn. 2, p. 5) and United's Form 2 for 1964 (p. 514, Col. (f)), an annual report which the FPC requires to be filed, United showed that the 80% of Union's gas sold to United constituted only 11% of United's gas supply. Form 2 shows that United in 1964 sold 1,438 billion cu. ft. Corporation's 1964 annual report shows that Corporation sold a total of 95 billion cu. ft. 96% (FPC 5) of 95 billion is 91.2 billion. This 91.2 billion cu. ft. sold by United to Corporation is 6.34% of the 1,438 billion total sales by United. Thus, 11% of the 6.34% or *less* than 1% of the gas purchased and sold by United represented gas which traveled from wellhead to burner tip through the Union-United-Corporation company group facilities. As we pointed out below, all of this information was available to the FPC before it wrote its brief below as well as this Petition.

dated group, and that thereby there is freedom "against entrepreneurial risks." The record refutes these pretensions. Memphis' Ex. 36 (revised) R. 6524, shows that the profits for the five years of the parent, Corporation, would alone be sufficient to offset Union's losses for such five year period. Nothing in the record supports the inference sought to be cast by the phrase, "against entrepreneurial risks". United's pipeline business is at no point manipulated to cover improper or improvident risks to be used to create what the FPC calls "tax savings."

This is of a class with the phrase (p. 12) "fully regulated members of the group". The FPC, of course, knows that no member of United's consolidated group is "fully regulated". The FPC confesses it regulates only 44% of United (fn. 1, p. 4). It knows it regulates only the interstate wholesales of gas of Union. It also knows that it has no regulatory supervision of Corporation, nor Overseas.

The FPC (p. 12) indulges in fanciful, unsupported conclusions about the advantages of affiliation. These ideas are wholly irrelevant to the issues here — viz, whether the FPC may transgress the jurisdictional bounds of the Act and take unrelated, non-jurisdictional, non-utility tax losses belonging to an affiliate and give them to the jurisdictional customers of another affiliated but partially regulated company. Neither the joys nor woes of "a vertically integrated enterprise", nor whether affiliation might furnish "an assured market"[8] shed any light on whether or not the Fifth

[8] The cavalier suggestion of "assured market" to Union (FPC p. 12) is as unfaithful to the record as the claim that the Fifth and Tenth Circuit decisions held the FPC without any power to adopt an allocation, is unfaithful to those decisions.

Rebuttal testimony of United's Vice-President C. C. Barnett (R. 86-122) is a complete exposition of the gas purchasing practices and policies of United. Nine factors (R. 87) control such purchases. We here lift up four: (1) United's contractual "take" obligations with various producers, (89% of these pur-

and Tenth Circuit decisions rightly called the turn on the FPC for its illegal attempt to override the limits of jurisdiction Congress marked out in the Act. Nor do such ideas change the fact that United's jurisdictional customers contributed nothing to the creation of Union's oil losses which the FPC is undertaking to kidnap.

Controlling Regulation, Qua Statutes, Require Preservation of Separate Entity. The FPC attempts to equate its claimed power to "allocate" consolidated tax liability among the members of a consolidated group with the Congressional intent underlying the consolidated return provisions of the Internal Revenue Code, citing (p. 13) *Erie Lighting*

---

chases come from non-affiliated; 11% from Union, see *infra*, p. 11, fn 7); (2) State conservation and proration orders of local regulatory agencies in Texas, Louisiana and Mississippi, by which production allowables appear to each producer; (3) the "takes" of other purchasers within the same fields; and (4) United's obligation to all of its producers to govern its "takes" to prevent them being injured by drainage. Staff subjected Barnett to wide-ranging cross-examination (R. 2502-2640; 2725-41) liberally laced with inquiry into managerial judgment both from a business and operational standpoint. Memphis re-covered the field (R. 2640-99). Others also crossed (R. 2699-2701; 2701-6; 2706-24). The cross-examination so clearly and starkly confirmed the correctness and propriety of these practices, that Staff witness abandoned his exhibit pointed to a modification of some of those practices, and accepted in toto United's dispatching of estimated 1963 volumes (R. 4173, 4174).

The sum of all of the foregoing, undisputed as it was, conclusively showed that Union did not have and could not obtain an "assured market", but that it fell into its own contractual slot as did each other producer from whom United purchased.

We apologize to this Court that the record references in this footnote were not included in the Joint Appendix. We trust this Court will understand that the issue here is the validity and propriety of the contrived device labelled "consolidated effective tax rate", and not United's policies and practices with respect to purchased gas, including that purchased from Union, *all of which was fully covered by and included within the terms of the settlement of all issues save this "tax" issue.* The Commission order approving the settlement of all issues except the tax issue is at 32 FPC 1515, et seq.

Co. v. *Com.* (1937, 1 Cir.) 93 F. 2d 883, and two Congressional reports (one relating to the Revenue Act of 1928, the other, to that of 1934).[9] These citations contain references to those portions of the respective Revenue Acts dealing with consolidated returns. It is difficult to see how Congress, in 1928 and 1934, could have been concerned with the FPC's power to "allocate", for rate making purposes, the tax liability of a consolidated group, when the FPC and the Act under which it subjects United to its jurisdiction was not yet in existence.

The alleged Congressional sanction which the FPC seeks from the cited Congressional reports fails completely when it is recognized that such reports relate to Revenue Acts long ago expunged from the tax statute.

The separate company identity concept is expressly provided for in the current consolidated return Regulations, which have the force of law, promulgated under this Statute in effect during the pertinent period.

The authoritative work entitled "Consolidated Tax Returns" (Callaghan & Co., 1959) by Fred W. Peel, Jr., contains a passage which clearly refutes the single entity theory espoused by the FPC. Mr. Peel states (p. 1-2):

> "The consolidated return computations are not, however, based on a consolidated accounting of all income and capital items as though the properties of the subsidiaries were owned by the parent.[1] As the principles

[1] Unlike the rules provided in the present Regulations, consolidated returns originally involved a thorough going application of the principle of consolidation of accounts . . ."

[9] Under the 1928 Revenue Act, which is the subject of S. Rep. No. 960, the right to file consolidated returns was accorded to most affiliated groups of corporations. Under the Revenue Act of 1934 (H. Rep. No. 704), these rights were completely abolished and repealed except as they related to railroad corporations.

> governing consolidated returns have developed since 1917, this concept has been rejected. Instead, for most items there are separate computations for each corporate entity. The incomes so computed are then combined and adjusted by certain consolidated computations to arrive at consolidated taxable income."

This is precisely the procedure followed by the United consolidated group.

FPC Reliance on El Paso Misplaced. The FPC (p. 13-4), says that where a regulated pipeline company owns its own production the tax losses *"resulting from its gas operations"* are utilized in computing the tax allowance for that pipeline, and referring to *El Paso Nat. Gas Co.* v. *FPC*, (1960 5 Cir.) 281 F. 2d 561, cert. den. *sub nom California* v. *FPC*, 366 U.S. 912, asks what the difference is where such production is owned by a separate corporation. Apart from the fact that in the latter case there are separate owners instead of one owner, the short answer is that even on its own selected basis the FPC does not assert power to utilize *unregulated oil* tax losses, yet they are the losses here involved. Furthermore, *El Paso* stands for the principle that true "tax savings" of a regulated company obtained in respect of its regulated business, *i.e.* gas operations, are available to the regulatory agency. This principle would cover the first instance posed, where the regulated company had its own production. That it would not in the second is clear. The FPC sought to get under the tent of *El Paso* to justify its so-called "allocation" here — but the Fifth Circuit did not buy the attempt.

In any event, when the FPC specifies *"gas operations,"* as it does, it removes the point from this case which involves *oil operations.*

NO IMPORTANT FEDERAL QUESTION CALLING FOR SUPERVISION OF THIS COURT

Issues Judicially Reviewed. We find the approach in the two petitions here curious. The argumentative rationale of the FPC's *Cities Service* decision, 30 FPC 158, the Tenth Circuit rejected and vacated, holding that the FPC "devised a method" for computing tax allowance which transgressed the jurisdictional requirements which Congress wrote into the Act, because such method did not make an effective separation of regulated and non-regulated activities requisite to the determination of the ingredients of the rate base. Thus it breached this Court's warning that "Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act." *Panhandle Eastern Pipeline Co.* v. *FPC*, (1945) 324 U.S. 635, 641.[10]

---

[10] This "off-limits" declaration was also proclaimed in *Colorado Interstate* v. *FPC*, (1945) 324 U.S. 581, cited by Memphis (p. 6) in which the Court declared:

> "Colorado Interstate and Canadian object to the Commission's use of the return. The Commission included in the total cost of service for these companies a 6½ per cent return on the rate base. In other words, the 6½ per cent return was computed on the basis of all the property used by petitioners in their various classes of business — intrastate sales, direct industrial sales, and interstate wholesale sales. Now it is apparent that if the reduction ordered was based on the excess of revenues from all classes of business over the aggregate costs, the result would be to reduce to a common level the profits from each class. In that case, whenever a company was making a higher return on its unregulated business than the rate of return allowed for the regulated business, the excess earnings from the unregulated part would be appropriated to the entire business. When the unregulated business was being operated at a loss or at less than the return which was allowed, excess earnings from the regulated business would be appropriated to the unregulated business. A low rate might therefore be concealed by siphoning earnings

Speaking of the Tenth Circuit decision, the FPC declared:

> "But that court decision which has now been issued is regarded by the Commission as clearly erroneous and one which the Commission must continue to regard as erroneous until the question is set at rest more authoritatively." (p. 21, FPC Response in 5th Circuit to United's Application for Stay.)

Instead of seeking correction of this "clearly erroneous" decision at the hands of this Court, it shopped a "conflict"[11] in the Fifth Circuit, asserting "fact differences" between this case and *Cities Service*. But the Fifth Circuit, after careful examination, found none as would require a different rule of decision.

No Basis for Claim of Hurtful Public Impact. But the instant petition abandons the "clearly erroneous", for it nowhere points to any legal error inherent in either decision; instead it advances a brand new approach, a strenuous effort to synthesize a public impact "horrendum" (p. 14-17). Memphis echoes (p. 4-5).

39 out of 77 pipelines (p. 15), says the FPC, file consolidated returns. Assuming this, arguendo, it presents no authority at the law for the FPC to transgress jurisdictional limits of the Act. Only Congress can stretch, or bend, or reset such limits. *El Paso*, as noted, recognizes FPC control over true tax savings had by a pipeline company from jurisdictional gas operations on production which that FPC regulated pipeline company owns. The Fifth and Tenth Circuit decisions hold the FPC may not go beyond

---

from the unregulated business; a high rate might be built up by making the regulated business share the losses of the unregulated one." (p. 593-4). While the facts there did not require application of the rule, the rationale is the same as that of *Panhandle*, above.

[11] The FPC candidly conceded the search for a "conflict" in footnote 31, its brief in the Court below.

its jurisdictional restrictions to seize non-jurisdictional *oil* losses. These well considered decisions, in our estimation, are correct and in accord with Congressional intent.

The FPC caps this speculation with the artful ambiguity that "presumably the motive in each case was tax savings" (p. 15). "Tax savings" is the foggy phrase. For if "tax savings" has reference to the purpose and benefit envisioned by Congress in the consolidated return provisions, then, whether "tax savings" or not, is irrelevant. But if "tax savings" is meant to refer to the contentions made in the Fifth Circuit, and the Tenth Circuit, then both Courts categorically held that no "tax savings" resulted from inclusion in the consolidated return of the affiliate whose unrelated, non-jurisdictional and non-utility tax losses and deductions were, in the guise of "allocation", sought to be appropriated. Furthermore, if the "presumably" phrase is calculated to infer some improper motive, the petition shows no basis or facts to warrant the inference.

What is said of the 39 pipeline companies is equally applicable to "sixty-one" major electric utilities, recited, without more.

The last sentence of the first paragraph "Each such instance raises the question whether the consumer shall share * * " (p. 15) provokes two observations. First, the FPC is not talking about a "sharing" by stockholders and consumers — but a pure flow-through. Secondly, if such a broad issue can be raised by the neutral fact of 39 consolidated-return pipelines, that fact could in no fashion be persuasive upon the narrow jurdisdictional issue which the Fifth Circuit correctly determined.

The "many millions of dollars" (p. 16) are just as wanting in catalogued substance, as the cases cited in footnotes 12 and 13 are devoid of relevancy here. We have dealt

with these cases below and before the FPC. None of them involved use of a "consolidated effective tax rate" under circumstances similar to those involved here, *i.e.*, where non-utility, non-jurisdictional tax deductions are used as the FPC would do here.

Straining for some semblance of authority, the FPC cites two early FCC cases (p 15-6) as examples of parallel agency practice. No such support is forthcoming. *West Indies* (p 15) involved the question whether the incidence of World War II excess profits taxes could be transferred to the customer. The FCC's 1943 Report concluding that Congress intended the excess profits tax to be borne by the carrier involved no question of consolidated returns nor non-jurisdictional tax losses.

Next, the FPC resorts to a footnote in an exhibit attached to a long opinion by the FCC in *Western Union Telegraph Co.* (p 15-6). This opinion seems to show that someone, at some point, for some unexplained purpose, made an allowance based on a consolidated return, which computation was not of sufficient importance to receive attention in the FCC opinion, and which the FPC here does not show to have involved any character of non-jurisdictional losses, "allocated" as here.

Memphis attempts to proliferate the "horrendum" by escalating the number of consumers whose "cost" of gas is allegedly increased by the Congressional provisions both in tax statutes and the Act which the Fifth and Tenth Circuits declare and uphold (p. 4). But the directions of Congress in tax statutes is one thing, and the regulatory directions in the Act is another, nor can compliance and obedience to the tax statutes be claimed to produce an unlawful result under the Act.

United is well aware of this Court's statement in *FPC* v. *Hope Nat. Gas Co.*, (1944) 320 U.S. 591, 610, to which Mem-

phis adverts (p. 5). Even there, this Court (p. 603) noted the Act involved "a balancing of the investor and the consumer interests" for the protection of "a legitimate concern with the financial integrity of the company whose rates are being regulated."

Too, Memphis seems to forget that this Court admonished it and the FPC that this "legitimate concern" was a tangible purpose of Congress in the Act, for in *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water,* (1958) 358 U.S. 103, this Court declared:

> "It seems plain that Congress, in so drafting the statute, was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices for natural gas, but was also manifesting its concern for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake. Business reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance; otherwise procurement of the vast sums necessary for the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible." (p. 113).

Memphis terms Union the "producing arm" of United, citing *Mississippi River Fuel* v. *FPC,* (1957 CADC) 252 F. 2d 619 and *Willmut Gas and Oil Co.* v. *FPC,* (1962 CADC) 299 F. 2d 111. But it neglects to disclose that both cases involved a period before producers (and Union) were subject to FPC regulation. Thus, under the general rule obtaining where a regulated company acquired services from an unregulated affiliate, the regulating agency was empowered to check such relationship and price to insure

no improper advantages resulted. The legal rationale was that regulation afforded sanction against abuse, and its absence authorized scrutiny. The District of Columbia Circuit so distinguished the cited cases of *American-Louisiana Pipe Line Co.* v. *FPC,* (1965 CADC) 344 F. 2d 525, see fn. 12, p. 532.

But there are other cogent reasons which in our submission expose the "horrendum" as artificial and without merit. If this adjudication of invalidity of the FPC device — invalid because the FPC transgressed the jurisdictional bounds of the Act — had any such public impact as that which the FPC and Memphis seek to create, it seems more than strange that the FPC didn't flee to this Court following the Tenth Circuit decision and assert it.[12] For if there be such an impact, which United flatly denies, such impact was going on before *Cities Service.* But the FPC never advanced it initially or by Motion for Rehearing to the Tenth Circuit. Nor did the FPC or Memphis cry it out to the Fifth Circuit.

Furthermore, the tidal wave advanced by Memphis seems to have died aborning. When United filed this proceeding in the FPC, Exhibit 1-1 (R. 4874), et seq, showed United had 56 jurisdictional customers. Only 11 of the 56 intervened in the FPC.[13] 27 customers of customers intervened,[14] including Memphis. Yet this "horrendum" is advanced for

---

[12] The FPC has said that *Cities Service* became moot because corporate rearrangement eliminated the right to make a consolidated return. This produces no mootness. Cities Service Ex. L FPC Dkt. CP65-162 shows that $4,545,000 depended upon the determination of this question, *i.e.,* if the FPC could do what it sought the judisdictional customers would be entitled to $4,545,000; if not, Cities Service would be entitled to this amount. This was far from moot.

[13] R. 7119; 7142; 7148; 7158; 7187; 7203; 7211; 7236; 7257; 7282; and 7302.

[14] R. 7131; 7137; 7165; 7171; 7179; 7194; 7217; 7229; 7242; 7248; 7263; 7270; 7293; 7327; 7334; and 7352.

the first time in these Petitions. Apparently two unanimous decisions from two Courts of Appeal which had effect to uphold the dissent of two Commissioners made a new approach imperative.

In any event, this area of the Petitions presents nothing, in our submission, calling for this Court's supervision.

CONCLUSION

United respectfully submits that these Petitions present no meritorious grounds for assumption of jurisdiction by this Court.

This record shows, indeed, in our submission, a careful assay of it, warrants the conclusion, that looking at the legal integrity of the Fifth and Tenth Circuit decisions, no doubt can exist that these Courts correctly construed the controlling principles enunciated by this Court, and that they have rightly declared the law.

Upon the coming in of the Tenth Circuit decision, the FPC characterized it as "clearly erroneous" and declared its refusal to obey pending more "authoritative" disposition. But the FPC failed, in truth it refused, to advise the Tenth Circuit wherein its decision was "clearly erroneous", thus depriving that Court of any opportunity to consider such complaints. Equally, it made no effort to seek from this Court which it had to know possessed adequate power,—any correction of "clear errors".

It followed the same course in the Court below. When, finally, it did seek entree to this Court, it does not assert "clear" or palpable error. Instead, it advances the astonishing claim that two decisions of two Circuit Courts of Appeal should be destroyed because conformity and obedience to law is not in the public interest. The claim of disastrous public impact, or, as we term it, the "horrendum" rings no clarion peal of credibility or merit.

The very timing of such claim in the light of the history of the Fifth and Tenth Circuit decisions, renders it suspect, for if the "horrendum" exists, which, in our opinion, the context of the Petitions denies, it does not result from the two decisions. The Petitions present the bold, bald claim that the jurisdictional limits of the Act prevents the FPC from confiscating unrelated, non-jurisdictional, non-utility tax losses and tax deductions belonging solely to a producer affiliate of a pipeline company under its jurisdiction, and thus prevents the FPC from donating these tax losses to jurisdictional customers of the regulated pipeline company as the proud fruit of unlicensed regulation. If the jurisdictional limitations are to be changed — only Congress has the authority.

Accordingly it is submitted that these Petitions for a Writ of Certiorari should be denied, and it is so respectfully prayed.

Respectfully submitted,

.....

THOMAS FLETCHER
2025 First City National
Bank Building
Houston, Texas 77002

Attorney for Respondent
United Gas Pipe Line
Company

Of Counsel:

W. O. CRAIN
General Counsel
P. O. Box 1407
Shreveport, La. 71102

K. W. KOLBE
C. D. FRENCH
2 Rector Street
New York, N.Y. 10006

LYNN R. COLEMAN
2024 First City National
Bank Building
Houston, Texas 77002